Taxation – Alternative Minimum Tax

MARKETING AND FARM BUSINESS MANAGEMENT WWW.GOV.MB.CA/AGRICULTURE/

October 2003

Introduction

Implemented in 1986, **Alternative Minimum Tax (AMT)** was introduced to address concerns that some individuals and trusts with high gross incomes paid little or no income tax. It usually arises in agriculture tax situations when farm property such as land is sold and the combination of regular taxable income and 60% of the non-taxable capital gains exceeds $40,000. This amount is subject to a flat tax currently set at 16%. Retiring farmers selling farm property and incurring significant capital gains are most likely to be affected.

Tax legislation continues to change and the information contained in this Information Update is based on the prevailing tax legislation information at the date of publication.

If you have a tax situation that might trigger the Alternative Minimum Tax, it is strongly recommended that professional taxation and legal advice be obtained to manage the potential taxation liability.

This Information Update will illustrate how **AMT** can affect the estate plans of farmers.

When Does Alternative Minimum Tax Arise?

Farmers will most likely pay **Alternative Minimum Tax (AMT)** when **taxable capital gains** are reported, but may also be subject to AMT if one of the following situations arises:

- any of the following tax credits are claimed:
  - a federal political contribution tax credit
  - an investment tax credit
  - a labour-sponsored funds tax credit
- an overseas employment tax credit
- a loss (including your share of a partnership loss) resulting from, or increased by, claiming capital cost allowance (CCA) on certified films or productions
- a loss from a limited partnership
- claiming carrying charges on certain investments
- loss from resource properties from, or increased by, claiming a depletion allowance, exploration expenses, development expenses, or Canadian oil and gas property expenses
- employee stock option plan deduction and other deductions
- employee home relocation loan deduction

Exceptions for Certain Returns

- Special returns of incomes filed on behalf of bankrupt or deceased taxpayers.
- An ordinary return of an individual who died in a year.
- Partnerships are not subject to AMT, but individually the partners may be liable, depending on the circumstances.

Note: *A capital gain resulting from the sale of Eligible Capital Property such as dairy quota will not trigger AMT.*

Alternative Minimum Tax – A Five Step Process

1. Calculate regular Taxable Income based on the standard *T1 General* tax return.
2. Use **Form T691** to take the Taxable Income amount from Step One and calculate an Adjusted Taxable Income figure. A general exemption of $40,000 is then provided and is used to reduce the potential tax liability for the low to middle income tax bracket earners.
3. Multiply the result of Step Two by a flat federal tax of 16%. Total Non-Refundable Tax Credits are deducted from this figure to arrive at the **AMT amount payable**.
4. Compare the Federal Tax payable on the **T1 General** to the final calculation in Step Three. Whichever is the higher calculated figure, is the amount that will have to be paid. If the AMT calculation exceeds the regular Federal Tax, this excess amount can be carried forward for seven years and used to reduce regular federal tax payable.
5. Using **Form T1219**, calculate the Manitoba Alternative Minimum Tax by multiplying the **additional** Federal Minimum Tax payable by 50%.

Manitoba Agriculture and Food is Committed to
Your Future in Farming

Manitoba
Building for the Future

Taxation – Alternative Minimum Tax

MARKETING AND FARM BUSINESS MANAGEMENT WWW.GOV.MB.CA/AGRICULTURE/

October 2003

Introduction

Implemented in 1986, **Alternative Minimum Tax (AMT)** was introduced to address concerns that some individuals and trusts with high gross incomes paid little or no income tax. It usually arises in agriculture tax situations when farm property such as land is sold and the combination of regular taxable income and 60% of the non-taxable capital gains exceeds $40,000. This amount is subject to a flat tax currently set at 16%. Retiring farmers selling farm property and incurring significant capital gains are most likely to be affected.

Tax legislation continues to change and the information contained in this Information Update is based on the prevailing tax legislation information at the date of publication.

If you have a tax situation that might trigger the Alternative Minimum Tax, it is strongly recommended that professional taxation and legal advice be obtained to manage the potential taxation liability.

This Information Update will illustrate how **AMT** can affect the estate plans of farmers.

When Does Alternative Minimum Tax Arise?

Farmers will most likely pay **Alternative Minimum Tax (AMT)** when **taxable capital gains** are reported, but may also be subject to AMT if one of the following situations arises:

- any of the following tax credits are claimed:
  - a federal political contribution tax credit
  - an investment tax credit
  - a labour-sponsored funds tax credit
- an overseas employment tax credit
- a loss (including your share of a partnership loss) resulting from, or increased by, claiming capital cost allowance (CCA) on certified films or productions
- a loss from a limited partnership
- claiming carrying charges on certain investments
- loss from resource properties from, or increased by, claiming a depletion allowance, exploration expenses, development expenses, or Canadian oil and gas property expenses
- employee stock option plan deduction and other deductions
- employee home relocation loan deduction

Exceptions for Certain Returns

- Special returns of incomes filed on behalf of bankrupt or deceased taxpayers.
- An ordinary return of an individual who died in a year.
- Partnerships are not subject to AMT, but individually the partners may be liable, depending on the circumstances.

Note: *A capital gain resulting from the sale of Eligible Capital Property such as dairy quota will not trigger AMT.*

Alternative Minimum Tax – A Five Step Process

1. Calculate regular Taxable Income based on the standard *T1 General* tax return.
2. Use **Form T691** to take the Taxable Income amount from Step One and calculate an Adjusted Taxable Income figure. A general exemption of $40,000 is then provided and is used to reduce the potential tax liability for the low to middle income tax bracket earners.
3. Multiply the result of Step Two by a flat federal tax of 16%. Total Non-Refundable Tax Credits are deducted from this figure to arrive at the **AMT amount payable**.
4. Compare the Federal Tax payable on the **T1 General** to the final calculation in Step Three. Whichever is the higher calculated figure, is the amount that will have to be paid. If the AMT calculation exceeds the regular Federal Tax, this excess amount can be carried forward for seven years and used to reduce regular federal tax payable.
5. Using **Form T1219**, calculate the Manitoba Alternative Minimum Tax by multiplying the **additional** Federal Minimum Tax payable by 50%.

Manitoba Agriculture and Food is Committed to
Your Future in Farming

Manitoba
Building for the Future

A Basic Example of the AMT Calculation...

The following example highlights the basic mechanics of how the AMT calculation works for the 2003 tax year.

A farmer sells farmland in 2003 at $650,000. This land has a cost base of $250,000, resulting in a capital gain of $400,000. Since the farmer has a lifetime Capital Gains exemption of $500,000, regular taxable income reported on the **T1 General** form is not affected. Net Income from Farming Activities for 2003 is $35,000 as reported on **Form 2042** or **Form T1163**.

The spouse in this case has independent income. The farmer's personal exemption ($7,756) plus the exemption allowed for CPP contribution ($1,559) totals $9,315. A Non-Refundable Tax Credit of $1,490 is obtained by multiplying this figure by 16%. Federal tax, before the minimum tax calculation, is calculated as $3,935.

Using **Form T691** on the above example

Step One:

- Taxable income reported **(T1 General)** is $33,440 ($35,000 - $1,560 CPP self-employed deduction). + $33,440

Step Two:

- The capital gain of $400,000 multiplied by 30% represents the portion of capital gains that is added as income for AMT purposes. This amount is added irrespective of whether the $500,000 Capital Gains Exemption has been used in the regular tax calculation. + $120,000
- The total of these two figures is the Adjusted Taxable Income for Minimum Tax. **Total** $153,440
- The General exemption of $40,000 is subtracted. **Less** $40,000
- The resulting figure is Net Adjusted Taxable Income. $113,440

Step Three:

- This figure is multiplied by 16% to yield the Gross Minimum Amount Payable. $18,150
- Subtract the Total Non-Refundable Tax Credit as mentioned in the case description. - $1,490

Minimum Amount (Federal) $16,660

Step Four:

Basic Federal Tax is $3,935 (as mentioned above). The individual will pay the **larger amount** of the Basic Federal Tax or the Minimum Tax. **In this case the Minimum Amount (Federal) of $16,660 will be paid for the 2003 tax year.**

Step Five:

Manitoba's Alternative Minimum Tax is calculated by adding 50% of the additional federal AMT to the basic provincial tax. Using **Form T1219:**

• Federal Minimum Tax from **Form T691**	$16,660
Less: Basic Federal Tax	$3,935
	$12,725
50% of Additional Federal Minimum Tax	x 50%
Additional Manitoba Tax For AMT Purposes	$6,363
Add: Basic Manitoba Tax (before AMT calculation)	$2,745
Minimum Amount (Manitoba)	$9,108
Minimum Tax (Federal + Manitoba)	**$25,768**

In summary, the total 2003 tax bill to the individual is:

Federal Tax (AMT)	$16,660
Basic Manitoba Income Tax	$2,745
Additional Manitoba AMT	$6,363
Canada Pension Plan Premium	$3,119
Total Tax Payable	**$28,887**

What Happens in the Subsequent Years?

Alternative Minimum Tax in excess of ordinary or regular tax that would otherwise be calculated may be carried forward for seven years and used to reduce ordinary tax payable calculated in those years. In our example, the $12,725 from above may be carried forward to reduce federal tax payable to the extent that it exceeds the AMT calculation for those years.

In Conclusion: The Overall Effects of AMT

In this example, the individual pays the AMT and, providing that there is taxable income in the next few years, will have the federal tax reduced accordingly. The AMT has the overall effect of prepaying income tax of future years.

If the individual, however, has little or no taxable income in future years, it may be possible that the AMT amount paid may not be returned.

The AMT calculation can be complex and it is strongly advised that professional services be used when planning tax strategies. The information provided in this Information Update is based upon taxation legislation at the date of publication.

For Further Information Contact Your Local Manitoba Agriculture and Food Office.

Prepared By:
Robert McKenzie, P.Ag.
Farm Management Specialist

Scott Stothers, P.Ag.
Farm Management Specialist